**DEPARTMENT OF STATE REVENUE**

04-20110437.LOF

**Letter of Findings: 04-20110437**
**Gross Retail Tax**
**For the Year 2008**

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## ISSUES

**I. Excavator – Gross Retail Tax.**

**Authority**: IC § 6-2.5-1-2; IC § 6-2.5-2-1(a); IC § 6-2.5-2-1(b); IC § 6-2.5-3-1(a); IC § 6-2.5-3-2(a); IC § 6-2.5-4-1(b), (c); IC § 6-2.5-5-2; IC § 6-8.1-5-1(c); 45 IAC 2.2-5-6(c); Rhoade v. Ind. Dep't of State Revenue, 774 N.E.2d 1044 (Ind. Tax Ct. 2002); Mynsberge v. Dep't of State Revenue, 716 N.E.2d 629 (Ind. Tax Ct. 1999); Tri-States Double Cola Bottling Co. v. Dep't of State Revenue, 706 N.E.2d 282 (Ind. Tax Ct. 1999); USAir, Inc. v. Ind. Dep't of State Revenue, 623 N.E.2d 466, (Ind. Tax Ct. 1993); General Motors Corp. v. Indiana Dept. of State Revenue, 578 N.E.2d 399 (Ind. Tax Ct. 1991); Dep't of Treasury of Ind. v. Dietzen's Estate, 21 N.E.2d 137 (1939); Fell v. West, 73 N.E. 719 (Ind. App. 1905); 45 IAC 2.2-5-6(c); Sales Tax Information Bulletin 9 (August 2008).

Taxpayer argues that his purchase of a loader/excavator was exempt from sales/use tax because the equipment is used in the direct production of agricultural commodities.

**II. Ten-Percent Negligence Penalty.**

**Authority**: IC § 6-8.1-5-1(c); IC § 6-8.1-10-2.1(a)(3); IC § 6-8.1-10-2.1(a)(2); IC § 6-8.1-10-2.1(d); 45 IAC 15-11-2(b); 45 IAC 15-11-2(c).

Taxpayer asks that the Department exercise its authority to abate the ten-percent negligence penalty.

## STATEMENT OF FACTS

Taxpayer purchased a John Deere 310SJ loader and excavator in 2008. The Department of Revenue ("Department") determined that Taxpayer should have paid sales tax at the time the excavator was purchased. The Department issued a proposed assessment of sales/use tax. Taxpayer disagreed with the assessment and submitted a protest to that effect. An administrative hearing was conducted during which Taxpayer's representative explained the basis for the protest. This Letter of Findings results.

**I. Excavator – Gross Retail Tax.**

## DISCUSSION

Taxpayer maintains that the excavator is exempt because its use is "directly related to the production of corn and soybeans." Taxpayer explains that he purchased a former golf course and that he needed the excavator to remove trees and various obstructions from the newly acquired land in preparation for using the land to raise soybeans and corn.

Indiana imposes an excise tax called "the state gross retail tax" (or "sales tax") on retail transactions made in Indiana. IC § 6-2.5-2-1(a). A person who acquires property in a retail transaction (a "retail purchaser") is liable for the sales tax on the transaction. IC § 6-2.5-2-1(b).

Indiana also imposes a complementary excise tax called "the use tax" on "the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction." IC § 6-2.5-3-2(a). Use means the "exercise of any right or power of ownership over tangible personal property." IC § 6-2.5-3-1(a). The use tax is functionally equivalent to the sales tax. See Rhoade v. Ind. Dep't of State Revenue, 774 N.E.2d 1044, 1047 (Ind. Tax Ct. 2002).

By complementing the sales tax, the use tax ensures that non-exempt retail transactions (particularly out-of-state retail transactions) that escape sales tax liability are nevertheless taxed. Rhoade, 774 N.E.2d at 1047; USAir, Inc. v. Ind. Dep't of State Revenue, 623 N.E.2d 466, 468–69 (Ind. Tax Ct. 1993). The use tax ensures that, after the goods arrive in Indiana, the retail purchasers of the goods bear their fair share of the tax burden. To trigger imposition of Indiana's use tax, tangible personal property must (as a threshold matter) be acquired in a retail transaction. Rhoade, 774 N.E.2d at 1048. A taxable retail transaction occurs when; (1) a party acquires tangible personal property as part of its ordinary business for the purpose of reselling the property; (2) that property is then exchanged between parties for consideration; and (3) the property is used in Indiana. See IC § 6-2.5-1-2; IC § 6-2.5-4-1(b), (c); IC § 6-2.5-3-2(a).

As a threshold issue, it is the Taxpayer's responsibility to establish that the existing tax assessment is incorrect. As stated in IC § 6-8.1-5-1(c), "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made."

Nonetheless, Indiana law provides a number of exemptions from the sales and use tax including the "agricultural exemption" found at IC § 6-2.5-5-2 which states:

(a) Transactions involving agricultural machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for his direct use in the direct production, extraction, harvesting, or processing of agricultural commodities.

(b) Transactions involving agricultural machinery or equipment are exempt from the state gross retail tax if:

(1) the person acquiring the property acquires it for use in conjunction with the production of food and food ingredients or commodities for sale;

(2) the person acquiring the property is occupationally engaged in the production of food or commodities which he sells for human or animal consumption or uses for further food and food ingredients or commodity production; and

(3) the machinery or equipment is designed for use in gathering, moving, or spreading animal waste. (Emphasis added).

In relevant part, the rule found at IC § 6-2.5-5-2 is explained in the Department's regulation set out at 45 IAC 2.2-5-6(c) which states:

Purchasers of agricultural machinery, tools, and equipment to be directly used by the purchaser in the direct production, extraction, harvesting, or processing of agricultural commodities are exempt from tax provided such machinery, tools, and equipment have a direct effect upon the agricultural commodities produced, harvested, etc. Property is directly used in the direct production, extraction, harvesting, or processing of agricultural commodities if the property in question has an immediate effect on the article being produced. Property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process, i.e. confinement buildings, cooling, heating, and ventilation equipment. The fact that such machinery, tools, or equipment may not touch the commodity or livestock or, by itself, cause a change in the product, is not determinative.

As further explained in Sales Tax Information Bulletin 9 (August 2008), 20080827 Ind. Reg. 045080655NRA, the person acquiring the property must directly use the property in the direct production of food or commodities for sale and the person must be occupationally engaged in the production of food or commodities sold for human or animal consumption or for further use in food or commodity production.

IC § 6-2.5-5-2 like all tax exemption provisions, is strictly construed against exemption from the tax. Tri-States Double Cola Bottling Co. v. Dep't of State Revenue, 706 N.E.2d 282, 283 (Ind. Tax Ct. 1999); Mynsberge v. Dep't of State Revenue, 716 N.E.2d 629, 636 (Ind. Tax Ct. 1999). In construing tax statutes, a liberal rule of interpretation must be indulged in order to aid the taxing power of the state. Dep't of Treasury of Ind. v. Dietzen's Estate, 21 N.E.2d 137, 139 (1939). The statutes of this state relating to the assessment and collection of taxes are liberally construed in favor of the taxing powers. Fell v. West, 73 N.E. 719, 722 (Ind. App. 1905).

Nevertheless, the Department is well aware of the countervailing rule that a "statute must not be construed so narrowly that it does not give effect to legislative intent because the intent of the legislature embodied in a statute constitutes the law." General Motors Corp. v. Indiana Dept. of State Revenue, 578 N.E.2d 399, 404 (Ind. Tax Ct. 1991).

The issue is whether Taxpayer has met his burden of establishing that he is occupationally engaged in the direct production of agricultural commodities and that the excavator has an "immediate effect" on the commodities being produced.

At the outset, the Department does not take issue with Taxpayer's assertion that he is engaged in the production of agricultural commodities such as corn and soybeans. However, the relevant question is whether the excavator has an "immediate effect" on those very same commodities. The exemption statute sets out a "double-direct" test with the Indiana legislature having emphasized that – in order to obtain the exemption – the excavator at issue must have "an immediate effect on the article being produced." 45 IAC 2.2-5-6(c). In this instance, Taxpayer has failed to meet his burden of establishing that the excavator has an immediate and direct effect on the corn and soybeans. The Department does not question Taxpayer's assertion that the excavator was useful and necessary in preparing the land for agricultural purposes but – especially in light of the fact that tax exemptions are strictly construed – Taxpayer's protest must be denied.

**FINDING**

Taxpayer's protest is respectfully denied.

**II. Ten-Percent Negligence Penalty.**

**DISCUSSION**

Taxpayer believes that the imposition of the ten-percent negligence penalty is unwarranted and asks that the additional amount be abated.

IC § 6-8.1-10-2.1(a)(3) requires that a ten-percent penalty be imposed if the tax deficiency results from the taxpayer's negligence. IC § 6-8.1-10-2.1(a)(2) requires a ten-percent penalty if the taxpayer "fails to pay the full amount of tax shown on the person's return on or before the due date for the return or payment."

IC § 6-8.1-10-2.1(d) states that, "If a person subject to the penalty imposed under this section can show that the failure to... pay the full amount of tax shown on the person's return... or pay the deficiency determined by the department was due to reasonable cause and not due to willful neglect, the department shall wave the penalty."

Departmental regulation 45 IAC 15-11-2(b) defines negligence as "the failure to use such reasonable care,

caution, or diligence as would be expected of an ordinary reasonable taxpayer." Negligence is to "be determined on a case-by-case basis according to the facts and circumstances of each taxpayer." Id.

IC § 6-8.1-10-2.1(d) allows the Department to waive the penalty upon a showing that the failure to pay the deficiency was based on "reasonable cause and not due to willful neglect." Departmental regulation 45 IAC 15-11-2(c) requires that in order to establish "reasonable cause," the taxpayer must demonstrate that it "exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed...."

Under IC § 6-8.1-5-1(c), "The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." An assessment – including the negligence penalty – is presumptively valid.

The Department believes that Taxpayer erred in determining that the purchase of the excavator was exempt from sales/use tax. However, there is insufficient information to establish that Taxpayer's position was so egregious as to constitute "willful neglect." Based on a "case-by-case" analysis and after reviewing "the facts and circumstances of each taxpayer" the Department agrees that the ten-percent negligence penalty should be abated.

**FINDING**

Taxpayer's protest is sustained.

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